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Sunday, February 6, 2005

[E-mail this story to a friend](#)BOTTOM LINE: *Charles Lawton*

Bush plan for Social Security based on faulty assumptions

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President Bush is promoting his proposal for the reform of Social Security on the grounds that the current system is "going bust," that it needs to be fixed financially. In fact, his proposal goes far beyond mere financial tinkering. It represents a fundamental change in what Social Security is.

As originally conceived and currently structured, Social Security is a retirement, disability and survivors insurance program. As such, its financial health is determined by the laws of large numbers, that is, by the actuarial facts surrounding the population covered, the risks insured, the benefits promised and the premiums charged.

As with any insurance program, Social Security may become imbalanced as the actuarial facts change, and its future health - i.e., financial viability - will require adjustment of some or all of the program variables. The pros and cons of alternative adjustments can be debated, but they all are based on continuation of the basic insurance program.

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The president's proposal is far more radical. He proposes to change part of Social Security from a collective insurance program to a private savings program. His fundamental philosophical position is embodied in his phrase, "the ownership society." We are better served, he believes, by taking personal responsibility for our own retirement security, saving for it over our working lives and living off the proceeds of this virtuous behavior than we would be by continuing the collective insurance program we now have.

The reasons for making this fundamental change are essentially four: The actuarial facts surrounding the current system make it unlikely that young workers will ever get the benefits currently promised. Young workers will accumulate greater wealth (and thus enjoy greater retirement security) by investing in private accounts than by relying on the Social Security Trust Fund. It is preferable (economically and perhaps even morally) to cultivate a society of self-reliant, market-savvy investors prepared to take care of themselves than one of government-dependent entitlement seekers. The overall economy will be strengthened by the additional savings generated by private retirement accounts.

The first reason doesn't stand up to logical scrutiny. While changes in the relative shares of workers and retirees in the population will clearly have an impact on the long-term status of the Social Security Trust Fund, they don't make "going bust" its inescapable destiny or require dropping it altogether. When Congress started Social Security, it taxed employers and employees 1 percent of the first \$3,000 of earnings. Today, it taxes each 6.2 percent of the first \$90,000 of earnings.

In short, Social Security taxes have risen more than six-fold since its inception. Further tax increases combined with benefit changes could keep the program going into the future. Such changes may or may not be desirable, but they certainly can be made.

The second reason for fundamental change is based on an "apples to oranges" comparison. Historically, regular investments in a diversified mix of common stocks have produced a greater return than the same investment made in government bonds. In effect, owning companies has been more profitable than lending to the government.

However, using this fact as a way of saying, "You can do better with your retirement savings than the government" is based on a misrepresentation of the Social Security Trust Fund. It is not the collectively owned retirement savings of America's workers that has been too conservatively invested in low-interest government bonds. It is, rather, just an accounting entry, a way of keeping track of the payroll taxes that the Social Security Administration has collected.

It is not a trust fund owned by retirees, like the one inherited from Aunt Alice. It is the current balance of payroll taxes collected. It is used to pay benefits to current retirees and other beneficiaries. Any money left over is used by the government to finance whatever other needs it has - making war, conducting research,

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collecting taxes, etc.

Investing in the stock market may indeed be a better way to build wealth than buying government bonds, but that isn't the comparison to make. Social Security has been a "pay as you go" system, not a "save-and-invest" program. The president's proposal to move part of the system to a "save-and-invest" basis deserves to be debated on its merits not on the basis of an inappropriate "apples to oranges" comparison.

The third reason for the president's proposal - to cultivate a society of self-reliant savers and investors - is certainly laudable. In health care where our greatest threats come not from the harsh unknowns of a mysterious world but from the self-destructive effects of our own habits, it is clear that the greatest improvement will come from consumer education and changed behavior.

So too in the world of long-term financial care. Education, personal responsibility and intelligent behavior are the surest avenues to longer, more secure lives. To say that people are too dumb or too lazy to manage their own retirement plans flies in the face of one of the most fundamental tenets of a free society.

That said, the question remains how best to achieve this world of intelligence, self-reliance and security. That brings me to the final reason for Social Security reform - its impact on the overall economy. That's the topic for next week.

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